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**AGENDA ITEM 4**

**TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE**

**I. SUBJECT:** Medicare Part D Implementation

**II. PROGRAM:** Health Benefits

**III. RECOMMENDATION:** Staff recommends that the Board adopt Option 8:

1. distribute Medicare Part D Retiree Drug Subsidy (RDS) funds to the State of California in 2007 based on claims experience for prescription drug costs of State RDS-eligible members in 2006; and,
2. use the balance of RDS funds to reduce 2007 premiums for contracting agencies' Medicare Supplemental Plans.

**IV. ANALYSIS:**

**Background**

The Medicare Prescription Drug, Improvement and Modernization Act (MMA) signed into law in December 2003, established a voluntary outpatient prescription drug benefit program referred to as Medicare Part D (Part D) that will take effect January 1, 2006. Part D will provide a pharmacy benefit through approved Prescription Drug Plans (PDPs) to Medicare eligibles who do not have pharmacy benefits through their employers.

As an incentive to employers who already provide high quality prescription drug coverage to their retirees, Part D includes a Retiree Drug Subsidy (RDS). The federal RDS payments are 28 percent of actual drug costs between $250 and $5,000 per calendar year for Medicare-eligible CalPERS retirees and their Medicare-eligible spouses and dependents ("RDS-eligible members").

CalPERS is a plan sponsor and may apply for and receive RDS funds on behalf of State and contracting agency employers. The MMA and federal regulations do not explicitly address the method of distribution of the RDS by plan sponsors.

Medicare Advantage Prescription Drug Plans, such as the Kaiser Senior Advantage Plan, are eligible to receive payments directly for retirees who are enrolled in PDPs. Such plans assume all risk and employers cannot claim the RDS for retirees enrolled in these PDPs.

The CalPERS Board of Administration decisions and status of actions related to Part D include:

- In April 2005, the Board directed staff to:
  - Seek legislation to restrict enrollment in the CalPERS Health Benefits Program to Medicare-eligible members who do not enroll in an individual Part D Prescription Drug Plan (PDP). This bill (Negrete McLeod, AB 587) provides that CalPERS members enrolled in a prescription drug plan other than a Board-approved Medicare Advantage Prescription Drug Plan (such as Kaiser Senior Advantage) may not be enrolled in a CalPERS health benefit plan. Members who inadvertently sign up for Part D will have an opportunity to disenroll from Part D without losing CalPERS health benefits. (Though CalPERS cannot prohibit members from applying for Part D, existing CalPERS drug coverage is as good as or better than that provided under Part D. There is generally no benefit for CalPERS health plan members to apply for Part D.) AB 587 was signed by the Governor on October 5, 2005 (Stats. 2005, Ch 527, §1).
  - Apply for the RDS for Medicare-eligible members not enrolled in the Kaiser Medicare Senior Advantage plan offered by CalPERS (Kaiser Senior Advantage). CalPERS will apply for all State and contracting agency employers on an aggregated basis by the application due date of October 31, 2005.
  - Reassess and present the Board's Part D options again in 2006 for 2007.
- In September 2005, the Board requested staff to re-examine the issue of distributing RDS funds, and to provide the pros and cons of all options.

This agenda item provides a more detailed analysis of options presented to the Health Benefits Committee in September 2005. It includes eight options that would distribute the RDS funds to employers, use the funds to directly benefit RDS-eligible members, or a combination of the two. The Board may decide to apply different options to State and contracting agency employers, or to differently-sized contracting agency employers; however, this adds to the complexity of administration.

Staff recommends Option 8, wherein CalPERS would distribute Medicare Part D Retiree Drug subsidy (RDS) funds to the State of California in 2007 based on claims experience for prescription drug costs of State RDS-eligible members in 2006; and use the balance of RDS funds to reduce 2007 premiums for contracting agencies' Medicare Supplemental plans. This is the best-balanced option that meets the evaluation criteria as discussed below.

## Discussion

In analyzing the options for distribution of the RDS, staff assessed the degree to which the options would:

- comply with the Public Employees' Medical and Hospital Care Act (PEMHCA) and the federal Health Information Portability and Accountability Act (HIPAA);
- maximize incentives for contracting agencies to remain in the CalPERS health benefits program, in order to spread risk across the largest possible pool of members;
- not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates;
- allow a cost effective and administratively feasible method of implementation; and,
- benefit members.

It should be noted that, regardless of the option selected, the Department of Finance may withhold an amount equivalent to the amount of the RDS funds attributable to CalPERS drug expenditures for State RDS-eligible members.

***OPTIONS***

**Option 1: CalPERS distributes RDS to employers in 2007 based on claims experience for prescription drug costs for RDS-eligible members in 2006.** The State and contracting agencies would receive 28 percent of drug costs between $250 and $5,000 per calendar year based on the claims experience for their RDS-eligible members. Estimated administrative cost: $875,000.

***PROS:***

- Maximizes CalPERS access to RDS funds. (The CalPERS RDS application will aggregate all employers. This includes contracting agencies with low retiree health coverage contributions that would not otherwise qualify for the RDS if they individually applied.)

***CONS:***

- Not a viable option because of potential HIPAA violations. Under HIPAA, employee personal health information (PHI) must be protected from general exposure to employers. Staff has identified over 400 contracting agencies that have very low numbers of RDS-eligible members. In fact, over 100 contracting agencies have only one RDS-eligible member. Distribution of the RDS based on claims experience to these contracting agency employers would identify the individual(s) who had incurred the drug costs used to calculate the RDS. This would constitute a violation of HIPAA.
- Contracting agencies with low retiree health coverage contributions may receive RDS amounts that significantly exceed their retiree health coverage premium contributions.
- No direct benefit to members.

**Option 2: CalPERS distributes RDS to employers in 2007 based on the proportion contributed toward retiree health coverage premiums in 2006.**
For State and contracting agencies, CalPERS would calculate the amount to distribute to each employer by first calculating "contribution ratios" (the ratio of each employer's contribution toward retiree health coverage premiums to the total amount contributed toward retiree health coverage premiums by all eligible employers.) Secondly this "contribution ratio" would be applied to the total RDS reimbursement CalPERS receives from the federal government in order to calculate each employer's share of the RDS. Estimated administrative cost: $875,000.

***PROS:***
- Does not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates.
- Avoids potential HIPAA violations.

***CONS:***
- Contracting agencies with moderate contributions toward employee health coverage premiums may feel that they would get higher reimbursement by applying directly for the RDS on their own.
- No direct benefit to members.

**Option 3: CalPERS distributes RDS to the State in 2007 based on claims experience for member prescription drug costs for 2006 and distributes RDS to contracting agencies in 2007 based on the proportion contributed toward retiree health coverage premiums in 2006.** Estimated administrative cost: $875,000.

***PROS:***
- Does not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates.
- Avoids potential HIPAA violations.

***CONS:***
- Contracting agencies with moderate contributions toward employee health coverage premiums may feel that they would get higher reimbursement by applying directly for the RDS on their own.
- No direct benefit to members.

**Option 4: CalPERS distributes RDS to employers in 2007 on a per capita basis.**
For State and contracting agency employers, CalPERS would reimburse each employer a set amount for each of their RDS-eligible members, based on average prescription drug costs for these members. The average prescription drug cost would be calculated by dividing the total amount of drug expenditures by the total number of RDS-eligible members in the CalPERS program. Estimated administrative cost: $875,000.

***PROS:***

- Avoids potential HIPAA violations.

***CONS:***

- Contracting agencies with low contribution rates may receive RDS amounts that significantly exceed their retiree health coverage premium contribution rates.
- Contracting agencies with high or moderate contributions toward employee health coverage premiums may feel that they would get higher reimbursement by applying directly for the RDS on their own.
- No direct benefit to members.

**Option 5: Use RDS funds to reduce 2007 premiums for Medicare Supplemental Plans.**

After the base premiums for 2007 are negotiated, CalPERS would distribute the RDS to the health plans based on claims experience for each plan's RDS-eligible population. CalPERS would then reduce the overall premiums for the Medicare Supplemental plans by the amount of the RDS that each health plan received. Estimated administrative cost: $775,000.

***PROS:***

- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates.
- Directly benefits members.
- Has the least impact on existing operations; and the easiest additional infrastructure to incorporate.
- Minimizes administrative cost to approximately $775,000.

***CONS:***

- Lower savings for the State than other employer disbursement options because some of the savings obtained through lower premiums would be spent on buying down retiree Medicare Part B premiums.
- Lower savings for some contracting agencies than other employer disbursement options. (Employers that contribute a flat amount for health premium costs would not realize savings if the lowered premiums are still higher than the amount of the employers' premium contribution.)
- Contracting agencies with high or moderate contributions toward employee health coverage premiums may feel that they would get higher reimbursement by applying directly for the RDS on their own.

**Option 6: Use RDS funds to reduce prescription drug co-payments for Medicare Supplemental Plans for 2007.**

Adjust benefit design to reduce prescription drug co-payments for 2007 based on the amount of the RDS that CalPERS projects it will receive for the 2006 benefit year. Reduction or elimination of co-payments would result in higher premiums for Medicare Supplemental plans; higher premiums would then be "bought-down" through use of the RDS. (To reduce co-payments by reimbursing individuals would require writing individual checks, dramatically increasing administrative costs and chances for error.) Estimated administrative cost: $775,000.

***PROS:***
- Avoids potential HIPAA violations.
- Direct benefit to members.
- Minimizes administrative cost to approximately $775,000.

***CONS:***
- Contradicts previous Board policy and action on prescription drug co-payments.
- Lower member prescription drug co-payments and deductibles may reduce the incentive for members to use generic and formulary drugs in preference to non-formulary drugs. Resulting changes in behavior could result in increased premiums in future years.
- Employers receive virtually no RDS and are likely to dispute this method of implementation.

**Option 7: Distribute RDS to employers and RDS-eligible members in 2007 based on the proportion each contributed toward health coverage premiums in 2006.**
CalPERS would calculate the average prescription drug cost by dividing the total amount of drug expenditures by the total number of RDS-eligible members in the CalPERS program. CalPERS would divide the average prescription drug cost between each RDS-eligible member and their employer, based on the percentage that each contributed to the total health coverage premium cost. Individual checks would be prepared and sent to eligible individuals. Estimated administrative cost: $1,500,000.

***PROS:***
- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates.
- Benefits members in proportion to their expenditures for prescription drugs

***CONS:***
- Contracting agencies with high or moderate contributions toward employee health coverage premiums may feel that they would get higher reimbursement by applying directly for the RDS on their own.
- Implementation would be complex and costly, approximately $1,500,000 in administrative costs.

**Option 8: Distribute RDS in 2007 based on claims experience of State RDS-eligible member in 2006 and use the balance of RDS funds to reduce 2007 premiums for contracting agencies Medicare Supplemental plans.** Estimated administrative cost: $775,000.

***PROS:***

- This is the best-balanced option that meets the evaluation criteria.
- Maximizes CalPERS' access to RDS.
- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates.
- Directly benefits contracting agency members while recognizing contracting agency employer contributions.

***CONS:***

- No direct benefit to State members.
- Lower savings for some contracting agencies than other employer disbursement alternatives because some of the savings obtained through lower premiums would be spent on buying down Medicare Part B premiums.
- Contracting agencies with high or moderate contributions toward employee health coverage premiums may feel that they would get higher reimbursement than by applying directly for the RDS on their own.

## V. STRATEGIC PLAN:

This proposal supports Strategic Plan Goal III, which requires CalPERS to design, develop and administer benefit programs and business processes that are innovative, effective, efficient and valued by our members, employers and stakeholders.

## VI. RESULTS/COSTS:

Attachment 1 reflects estimated RDS distribution and administrative costs for each option.

Staff is developing processes related to the administration and distribution of RDS funds. Staff will assess whether legislation is needed to support implementation. If legislation is necessary, the Office of Governmental Affairs (GOVA) will present the proposed legislation to the Board as part of the CalPERS proposed legislative program for 2006.

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Attachment